The Real Estate ANALYST

JULY 23
1954

Volume XXIII

Number 32

As I see it

HE THAT CANNOT SEE WELL, LET HIM GO SOFTLY *

THE present real estate boom is different from any that have gone before. It has continued year after year, until now it has lasted for 2 years longer than any other we have ever had. There are many reasons for this continuing activity, and some reasons for believing that it will continue for an indefinite period into the future. Some well-informed, intelligent students of our economy believe that this will be the case.

I can advance many reasons which seem convincing to me for thinking that no real collapse can occur. I would like to emphasize that I would be greatly surprised if a drastic real estate depression were to develop in the near future.

Were I not of this opinion, however, I would be at variance with the general pattern of the economists and the professional forecasters of the past. Well-informed people toward the end of each boom period of the past were always of the opinion that no collapse could occur, and they could marshal many reasons which were convincing to them for their opinion. They were wrong then, and there is the chance that those of us who believe that no drastic readjustment will take place may be proved wrong again, in spite of the seeming logic of our arguments. I would like to call, therefore, the extreme length of the present boom, "warning number one" - something not convincing in itself, but still something which the wise will watch quite carefully.

It is quite probable that the greater length of the present real estate boom is due to the fact that it followed the longest real estate depression in history. The depression of the thirties was a long depression in general business, but it was a far longer depression in real estate. The lowest part of the depression in general business was reached in 1932. Selling prices of real estate, however, declined until 1936 before starting a very slow recovery. The real estate boom which we are now in is probably longer than previous real estate booms because it takes longer to correct the maladjustments which developed in the longer real estate depression.

It should be noted, however, that the acceptance of this reasoning offers an explanation for the length of the present real estate boom, but does not rule out the possibility of a drastic readjustment later.

It can also be argued with considerable success that the real estate booms in the past have continued until monetary stringencies developed which brought on forced liquidation. Insofar as this is true, it is now argued that monetary stringencies in the future can be prevented by the manipulation of the credit machinery by the United States Treasury and the Federal Reserve System. It can also be suggested that the Federal Government, through its guaranteeing program of the FHA and the VA, now has a very major interest in seeing real estate prices maintained at or near their present level. Should real estate prices drop, the FHA and the VA would be called upon to make good on many of their

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guaranties of unsound mortgages.

In the past 100 years there have been only two periods in which the foreclosure rate went to great heights in urban areas. The first was the great depression of the seventies, culminating in a very high peak of foreclosures in the year 1878, and the second was in the depression of the thirties, when foreclosures, had it not been for the HOLC, would have surpassed the heights reached in the depression of the seventies. Foreclosures went to only intermediate heights during the big real estate depressions of the nineties and the real estate depression which accompanied World War I. Why did foreclosures go so high in the depressions of the seventies and the thirties, and to only intermediate heights in the nineties and during World War I? It seems to me that these two tremendous foreclosure peaks resulted from similar causes. In each case they were preceded by a monetary inflation, war induced, which lasted for a rather long period. A short rise in the price level followed by a drop does not materially affect real estate, but if the price level rises and stays high for a long period of years, construction costs rise, followed by a rise in the values of existing buildings, until the selling prices of existing buildings are so high that new buildings can be built in competition. Mortgage indebtedness gradually becomes accustomed to this new high level. This occurred during the late sixties and early seventies (the Greenback Inflation). When the inflation subsided, it became possible to build new houses for less than the amount owed on the old, and foreclosures skyrocketed. The same cause and effect occurred in the inflation which followed World War I, which was brought to an end by the depression of the thirties. Ninety-three percent of the large buildings built in the last period of the boom of the twenties went through foreclosure.

If there have only been two times in the past 100 years when foreclosures were quite high in the United States, and if the logical explanation for the height of these foreclosure peaks in both cases lies in an extended war inflation which preceded, we should remember that we are now in the period of the war inflation which accompanied and followed World War II, heightened still more by the inflation caused by the Korean War. We should also remember that this inflation has continued long enough for real estate indebtedness to become accustomed to the new level, and that any downward movement in the general price level and in the cost of building a new building would result in the possibility of building competing space at a lower price, in many cases, than the mortgage indebtedness on the older properties. This is the exact setting which caused high foreclosures before. While there are many reasons for believing that the Government will be able to prevent any drastic lowering in the general price level, nevertheless it seems to me that the wise investor will call this "warning number two," and will watch all factors which affect the construction cost of new buildings and the selling price of buildings already built.

Of course, it can be argued that we now have more control over the price level than we have ever had in the past, and because of the Government's stake in the mortgage picture at the present time, it cannot afford to allow real estate prices to drop. This is probably true, but on the other hand, I know of no period in the past where inflation had continued for a period of years in which the informed individuals did not hold the same opinion - that is, that prices could not drop and would probably go higher. Again, in believing that we will not have a tremendous foreclosure peak in the period ahead, I may be committing the same error that economists and professional forecasters have committed toward the latter part of every boom we have had.

There has been a sequence of events in real estate booms and depressions in the past

in the United States which has never varied. The boom starts when demand for residential dwelling units expands rapidly after a period in which the demand has been slight, with low rents and low values. As demand expands, vacancies are absorbed and the housing shortage which ensues causes rents and values on existing properties to rise rapidly. This rise continues until properties sell for too high a price in comparison with their replacement cost new, creating a strong incentive for the speculator to increase the amount of housing. The building boom gets under way, and since at the peak a building boom employs, in one capacity or another, about one-fifth of the producing capacity of the country, the building bocm itself proves a powerful stimulant to general business, the increased general business increases housing demand still more, and the housing shortage becomes more acute, in spite of the fact that we are now producing dwelling units at a rapid rate.

As the boom continues, however, it reaches the point where dwelling units are being increased at a greater rate than the increase in the number of families, and after this has continued for some time, vacancy in residential units starts to increase, slowly at first, then more rapidly. About the time, however, when residential vacancy starts to increase, the construction boom catches hold on commercial and many other types of building. The new homes have created new neighborhoods, the new neighborhoods need new shopping centers, new roads, new sewers, new water lines, etc. Old highways and boulevards must be widened. The general prosperity by this time has gotten to the point where demand for many items has increased so rapidly that industrial plants must be enlarged, with a need for a great deal of additional office space. Toward the end of every real estate boom in the past we have started to build big buildings, and in the past when we built office buildings and hotels in large quantities, we were hovering on the brink of the depression.

It is needless to point out that in the recent past, after a cessation of approximately 20 years, we are again building large buildings. Office construction, in many large cities, has spurted in the last year or so, and it seems to me that in the coming year it will increase still further. Since in the past the building of this type of space has come at the end of the real estate booms, and in spite of the fact that there are many explanations possible of why this building is logical and will continue for many years, it seems to me that the wise investor would call this "warning number three."

Of course, I realize that there are many reasons why we need additional office space and why, with the greater mobility of our population, new hotels are necessary. I would find it very easy to convince myself that the construction of large buildings is a natural procedure which carries with it no connotations of the end of an era, but again I am reminded that the economists and the professional forecasters of the past always arrived at a similar conclusion, and in the past were wrong.

Some stock market analysts claim that the stock market normally goes through three phases in a bull market, and that the last phase is the explosive rise which precedes the collapse. Many of these analysts believe that we are now in the third phase of the present stock market boom.

I do not claim to be a security analyst, and I know that I cannot accurately forecast changes in the prices of common stocks. The only stock market forecast which I thought was safe was: "The stock market will continue to fluctuate."

There is no question of the fact, however, that the stock market has shown remarkable strength for a long period of years and that it has now hit a 25-year high.

There are many reasons to justify the strength of the stock market, and certainly there are many reasons to believe that the situation is more fundamentally sound than it was in 1929. At that time only a 15% margin was required on stock market purchases against 50% at the present time. At that time, brokers' loans amounted to almost $7 billion as against slightly more than $1 billion at the present time. The number of shares traded per month in 1929 was more than double the amount traded now. In 1929, stock prices were bid up until the yield on stocks was considerably less than the yield on corporate bonds. Today, stock yields are still considerably better than corporate bond yields, as they should be.

Large trust funds have been accumulating stocks for their portfolios, and at the present time it is probable that a far larger percentage of stocks are in strong hands and are being held for investment rather than for appreciation. Accordingly, a smaller percentage of the stocks are apt to be thrown on the market at any one time than was true in the past.

It seems to me that the stock market may go considerably higher before any approach is made to the excesses of the 1929 situation. I think it is quite possible that advances in the average selling prices of stocks will continue to take place for some time in the future, but with each succeeding advance the future of the market becomes less certain than it was before the advance took place. It is with some hesitancy, therefore, and with a rather feeble voice that I mention the securities market as "warning number four." I also take encouragement from the fact that when the stock market has collapsed before, there has been some interval of time before this collapse was shared to a great extent by real estate.

While pointing out the preceding "four warnings" I find myself in a peculiar position. I have a great deal of confidence in the Administration in Washington, and I believe that skillful navigation, if not impeded to too great an extent by Congressmen who have their eyes primarily on the vote-snaring possibilities of various types of unwise legislation, may bring us through the period ahead with only minor reactions in the real estate and construction field. As I have pointed out, however, in this report, this is the mistake which was made by many economists and professional forecasters toward the end of the last and other preceding booms.

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